Internal Audit Report

Maricopa Long Term Care Program (MLTCP/ALTCS)

May 2002

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May 31, 2002

Don Stapley, Chairman, Board of Supervisors
Fulton Brock, Supervisor, District I
Andrew Kunasek, Supervisor, District III
Max S. Wilson, Supervisor, District IV
Mary Rose Wilcox, Supervisor, District V

We engaged Arthur Andersen LLP, and KPMG LLP, to perform a review of the Maricopa Long Term Care Program (MLTCP). This audit was conducted in accordance with the Board approved audit plan. This review focused primarily on assessing the future profitability of MLTCP, claim payment accuracy, and information technology (IT) controls.

The consultants found some areas needing improvement. These, along with our recommendations, are detailed in the attached report. The highlights are:

- Profitability significantly decreased during FY2001.
- Controls need to be strengthened to avoid significant numbers of claim payment errors.
- Programmers have excessive access to files on the computer system.

We have attached our report package and MLTCP's response, which we have reviewed with the department's director and managers. We appreciate their cooperation. If you have questions or wish to discuss items presented in this report, please contact Eve Murillo at 506-7245.

Sincerely,

Ross L. Tate
County Auditor

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This report provides management with information about the condition of risks and internal controls at one point in time. Future changes in environmental factors and actions by personnel will impact these risks and internal controls in ways that this report cannot anticipate.

Executive Summary

Profitability (Page 7)

Historically, strong Maricopa Long Term Care Program (MLTCP) profit margins have kept the Maricopa Integrated Health System (MIHS) profitable as a whole; therefore, MIHS needs strong MLTCP profit margins to remain self-supporting. However, throughout FY 2001, MLTCP showed significantly decreasing profitability.

We estimated future MLTCP net operating income using two projection methods based upon different assumptions. One method, using 24 months of operating results, suggests that MLTCP could face annualized operating losses as soon as late FY 2003. The second method, using 7 recent months of operating results, shows a potential for operating margin stabilization and some FY 2003 profitability. Both methods project significantly lower net operating income than FY 2000 ($19M) or FY 1999 ($12M), and potentially less than FY 2001 ($7.4M).

We identified three factors that appear to have adversely affected MLTCP profitability:

- Competition from two other Arizona Long Term Care System (ALTCS) health plans operating in Maricopa County.
- Increasing Home and Community Based Services (HCBS) per member per month costs.
- General and administrative costs increases (relative to revenues).

MLTCP management should identify and implement strategic plans to manage adverse trends.

Claim Payments (Page 13)

MIHS does not appear to have developed systems or processes that identify or avoid certain claim payment errors. The auditors found claim payment errors such as duplicate payments and overpayments. MIHS should investigate the identified payment errors and recover overpaid amounts if feasible. MIHS should also strengthen claim payment process controls to detect errors and avoid duplicate payments.

Excessive Access (Page 15)

Programmers have access to production data and object files on the Managed Care system. Once the change has been approved through the change control procedures, they move the changes to production, which increases the risk of unauthorized modifications to the production environment. We understand that with the implementation of the new system later this year, this risk will no longer exist since the software vendor will maintain the new system. However, MIHS should restrict programmers from the current production files and allow read-only access until the new system is implemented.

Inactive Accounts (Page 16)

An excessive number of inactive and disabled accounts exist on the Managed Care system. The situation increases the risk that these accounts will be reactivated, thereby granting unauthorized levels of access to system resources. MIHS should review profiles for disabled and inactive user accounts and delete those that are no longer needed.

Unique Identification (Page 17)

System activity performed under the 'operator' account cannot be identified to any one individual. Staff is using this high-level account instead of their own assigned account to do their work. During the audit, staff profiles for staff who require system level privileges, were modified to grant the same level of access as 'operator.' The password to 'operator' should be changed and distributed only on a need to know basis.

Password Controls (Page 18)

Password controls are being bypassed on more than 65 percent of the user accounts defined on the Managed Care system. This control weakness increases the risk of unauthorized access and change to the Managed Care system. MIHS corrected this problem during the audit. We commend management for their prompt action.

Disaster Recovery (Page 19)

MIHS has not formally tested the disaster recovery plan. Without periodic testing of the disaster recovery plan, MIHS increases two risks; changes to the system may not be accounted for in back-up procedures and critical data may be missing from back-ups. MIHS should review and update the disaster recovery plan and test the plan periodically.

Introduction

ALTCS Historical Background

The Arizona Health Care Cost Containment System (AHCCCS) is an independent state agency organized to operate Arizona's Medicaid program. The Arizona Legislature approved and funded AHCCCS in 1981 as a prepaid capitated (revenue paid according to number of clients) managed care demonstration project under Medicaid. The Arizona Long-Term Care System (ALTCS) was implemented in 1988 under AHCCCS. The program offers long-term care, acute care, Home and Community Based Services (HCBS), behavioral health, and case management services at little or no cost to financially and medically eligible Arizona residents who are aged, blind, disabled, or have a developmental disability.

Participant Profile

ALTCS integrates its services into a single delivery package, coordinated and managed by eight program contractors in the state. The following table summarizes the eligibility criteria for ALTCS client members:

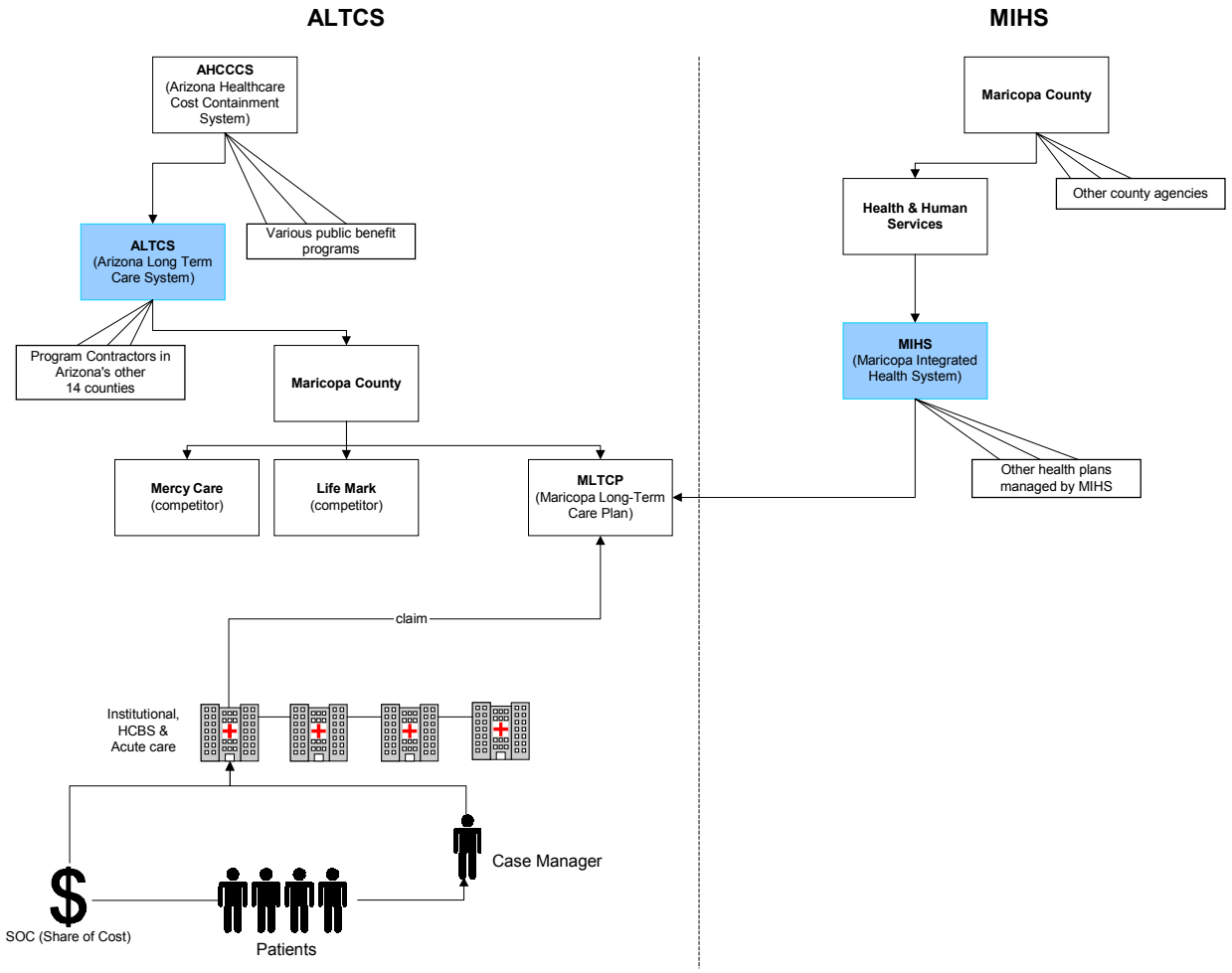
ALTCS Eligibility Criteria
• Arizona resident
• U.S. citizen or eligible alien
• Certified or applied for Social Security Number
• 300 percent of Supplemental Security Income or a maximum of $1,593/month
• No more than $2,000 in resources
• PAS (Pre-Admission Screening) (at risk of institutionalization)

ALTCS has experienced steady growth since its inception. As of December 2001, ALTCS served 33,232 members; 12,745 developmentally disabled and 20,487 elderly or physically disabled. Over half of statewide ALTCS beneficiaries reside in Maricopa County.

Maricopa County Program Contractors

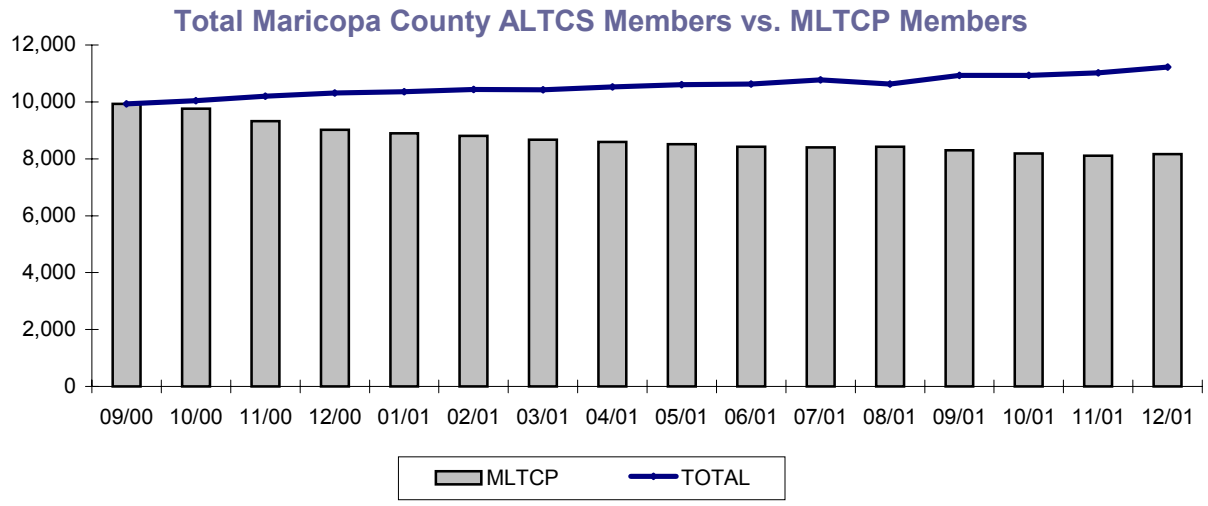
Prior to October 2000, the Maricopa Long Term Care Program (MLTCP) was the sole program contractor within Maricopa County. Beginning in October 2000, AHCCCS allowed members residing in Maricopa County to choose one of three ALTCS program contractors: MLTCP, Lifemark, or Mercy Care.

The Maricopa Integrated Health System (MIHS) administers MLTCP along with several other health plans. MLTCP manages a network of physicians, hospitals, nursing homes, and other providers to deliver services to its client members. The relationship between ALTCS, MIHS, MLTCP, and medical service providers is illustrated in the flowchart on the following page.

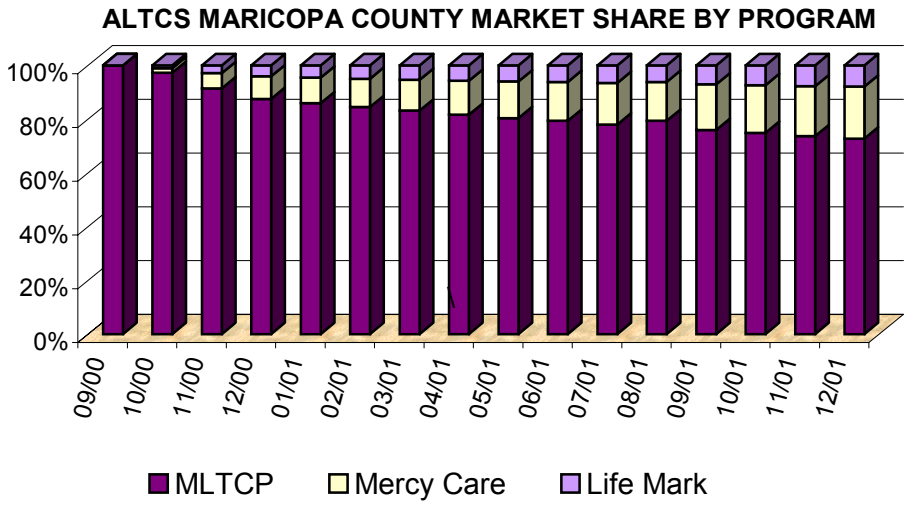


MLTCP Membership Trends

Since the October 2000 introduction of competing health plans, MLTCP has lost approximately 27% of its market share to Lifemark and Mercy Care. The graph on the following page shows that enrollment numbers in Maricopa County grew while MLTCP enrollment declined during the sixteen months ended December 2001.

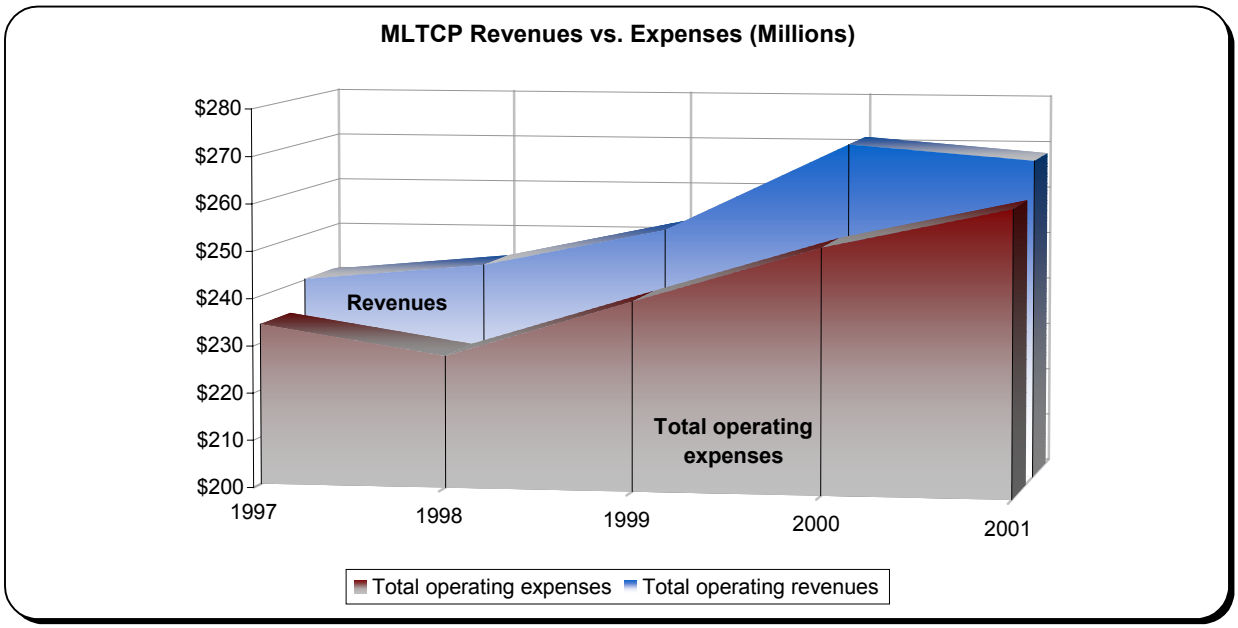


The following graph shows the steady erosion of MLTCP's market share. MLTCP's competitors are gaining new incoming members in addition to drawing members away from MLTCP.



Recent MLTCP Operating Results

MLTCP's revenues have consistently and favorably exceeded operating costs to date, as shown in the graph on the next page. However, beginning in FY 2001, expenses continued growing while revenues began to shrink. In FY 2001, revenues decreased 1.15% while operating expenses continued a four-year growth trend, increasing by 3.4%.



MLTCP's decreasing membership levels, decreasing revenues, and increasing expenses are reviewed in more detail in this report.

Audit Objectives and Scope

Scope of Work

- Analyze MLTCP's revenues and expenses in order to assess future profitability.
- Review claim payment system controls by testing for potential duplicate payments, overpayments, and whether other payors (i.e., Medicare) are available, but not used.
- Review MIHS' Quality Assurance process relating to claims payment accuracy review.
- Determine whether nursing home payment problems (related to share of cost) noted in the FY 1998 MLTCP audit have been corrected. (Note: The limited audit testing conducted during this review detected no nursing home payment problems related to share of cost.)
- Review issues addressed in AHCCCS' FY 2001 MLTCP Operational and Financial Review report and MLTCP's responses. (Note: The auditors noted no outstanding significant issues.)
- Perform an information technology (IT) review of IT controls over the County's VAX platform that supports Long Term Care processing.

This audit was performed in accordance with Government Auditing Standards.

Issue 1 Profitability

Summary

Historically, strong Maricopa Long Term Care Program (MLTCP) profit margins have kept the Maricopa Integrated Health System (MIHS) profitable as a whole; therefore, MIHS needs strong MLTCP profit margins to remain self-supporting. However, throughout FY 2001, MLTCP showed significantly decreasing profitability. The auditors attempted to estimate future MLTCP net operating income by using two projection methods based upon different assumptions. One method, using 24 months of operating results, suggests that MLTCP could face annualized operating losses as soon as late FY 2003. The second method, using 7 recent months of operating results, shows a potential for operating margin stabilization and some FY 2003 profitability. Both methods project significantly lower net operating income than FY 2000 ($19M) or FY 1999 ($12M), and potentially less than FY 2001 ($7.4M).

The auditors identified three factors that appear to have adversely affected MLTCP profitability:

- Competition from two other ALTCS health plans operating in Maricopa County.
- Increasing Home and Community Based Services (HCBS) per member per month costs.
- General and administrative costs increases (relative to revenues).

MLTCP management should identify and implement strategic plans to manage adverse trends.

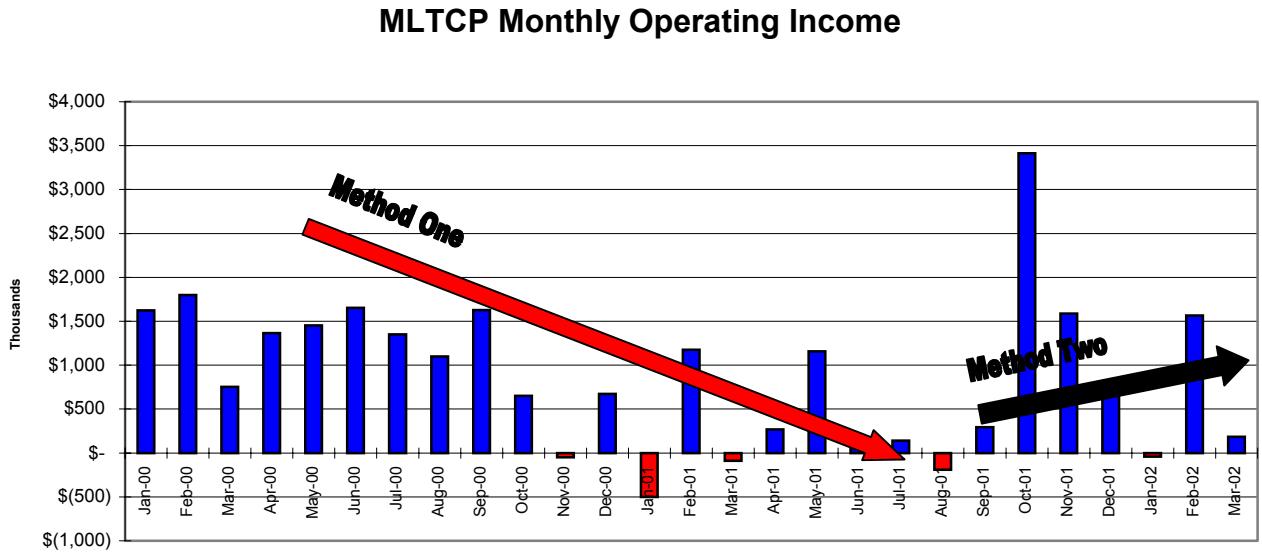
Importance of MLTCP Net Income to MIHS

Over the last four years, MIHS has remained profitable due to MLTCP's positive net income, as shown below. MIHS risks losing its overall profitability if MLTCP's profit margins decline.

Fiscal Year	MLTCP Total Net Income (Operating + Interest Earnings)	Total MIHS Net Income	Contribution by MLTCP
FY 1997	$10,293,527	$14,201,753	72.48%
FY 1998	$20,424,078	$16,113,621	Greater than 100%
FY 1999	$17,920,981	$15,665,634	Greater than 100%
FY 2000	$25,396,361	$18,124,734	Greater than 100%
FY 2001	$15,642,388	$ 4,605,555	Greater than 100%

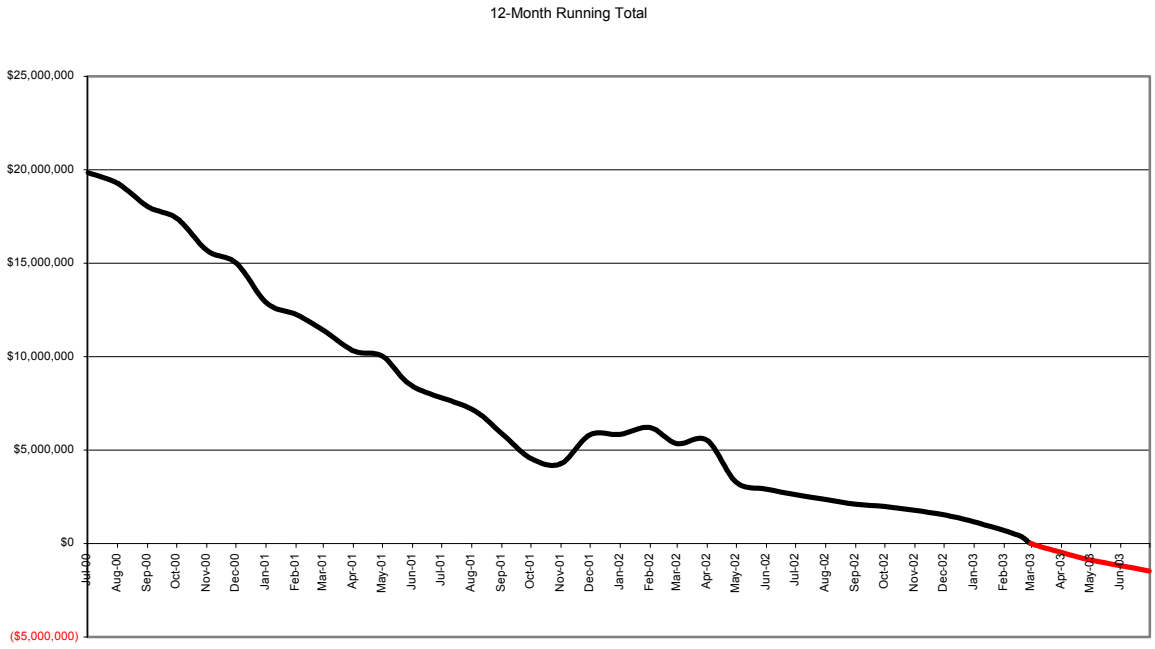
MLTCP Operating Margin Trends

The auditors endeavored to estimate future MLTCP operating margins by employing two analytical methods (discussed on the next page) that consider divergent MLTCP operational trends during the last 6-24 months. The analyses suggest a range of potential MLTCP operating outcomes. The chart on the top of the next page shows MLTCP fluctuating actual operating results during January 2000 through March 2002.



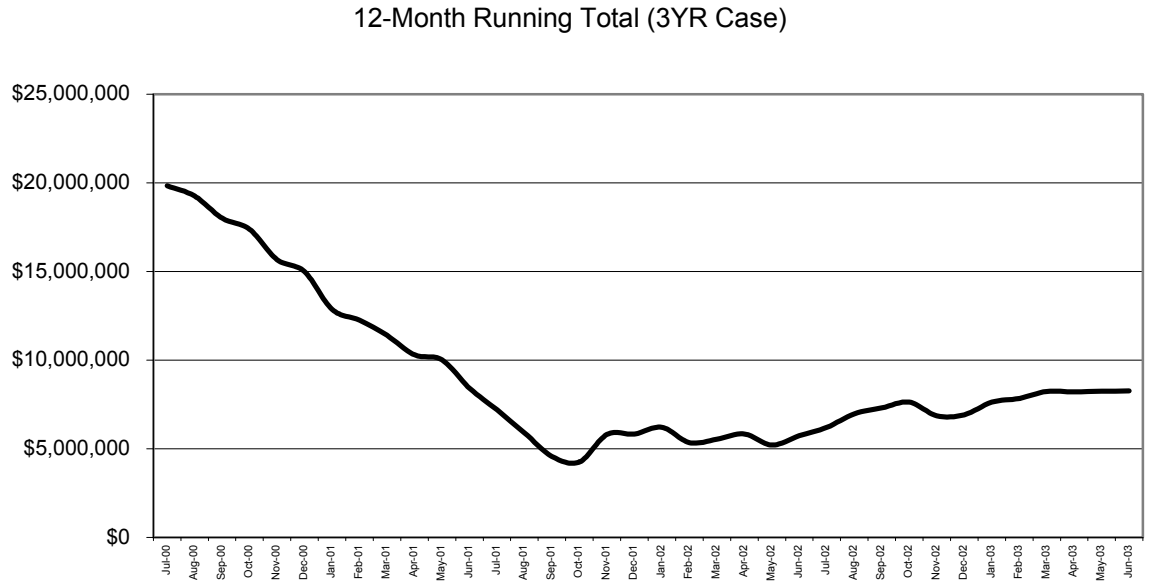
Method One: Trend long-term MLTCP annualized operating income

MLTCP's annualized operating income trend through August 2001 clearly shows a deteriorating financial condition (see chart below). The auditors used 24 monthly financial statements through March 2002 to trend MLTCP's net operating income and to project this trend 15 months forward. This method suggests that as early as FY 2003's third quarter, MLTCP risks not generating enough positive monthly operating income to offset negative operating income on an annualized basis. Each graph point corresponds to the sum of the preceding 12 months' operating results. The red line shows a negative trend for annualized operating results beginning in FY 2003.



Method Two: Trend short-term MLTCP annualized operating income

In method two, the auditors trended MLTCP annualized operating income from September 2001 to March 2002 to create a 15-month forecast (see chart below). The chart shows that the effect of the seven months ending March 2002 significantly shifts annualized operating income trends in a positive direction.



Analysis of Methods One and Two

The two analytical methods use different assumptions to estimate MLTCP's future net operational income and, therefore, offer divergent projections. Method One assumes continuance of MLTCP's long-term operating trend (24 months) and estimates FY 2002 year-end operational income at approximately $3.0M. Method Two assumes continuation of MLTCP's short-term operating trend (September 2001 – March 2002) and estimates FY 2002 year-end operating income at approximately $6.0M. If the two trend lines are extended into FY 2003, they show a range of potential net operating income between <$1.0M> and $8.0M. Significantly, both methods project significantly lower net operating income than FY 2000 ($19M) or FY 1999 ($12M), and potentially less than FY 2001 ($7.4M).

Volatility in month-end financial results (see MLTCP Monthly Operating Income graph on page 8) made forecasting difficult and resulted in the wide range of FY 2003 projected results. January 2002 closed at a loss of $42,830; February 2002 closed with a $1,565,618 profit; March 2002 closed at an income level of $184,911. NOTE: Because of month-end volatility, auditors used smoothing techniques in their analyses.

The ability to accurately predict future income, given the unpredictability of recent monthly results, is further compromised by future events that may affect income, such as:

- Capitation rate increases/decreases
- Changes in incurred but not reported (IBNR) reserve percentages
- Increasing medical costs

These and other potential events cannot be predicted and are, therefore, not included in the two methods used to forecast MLTCP net operating income.

Assess Net Income by Examining Cash Balance Changes

Auditors employed a third approach to analyze net income using the assumption that cash balance changes normally reflect net income activity. MLTCP cash balance changes through March 2002 appear to indicate that MLTCP's monthly net income, although positive, is declining. The most recent 12-month period shows average monthly cash increasing by $1.37 million per month, whereas the most recent 4-month period shows average monthly cash increasing by only $1.075 million per month. Due to other influences (cash capital purchases), cash balance changes are not the best indicators of net income. Nonetheless, cash balance changes indicate that MLTCP's monthly net income may still be declining.

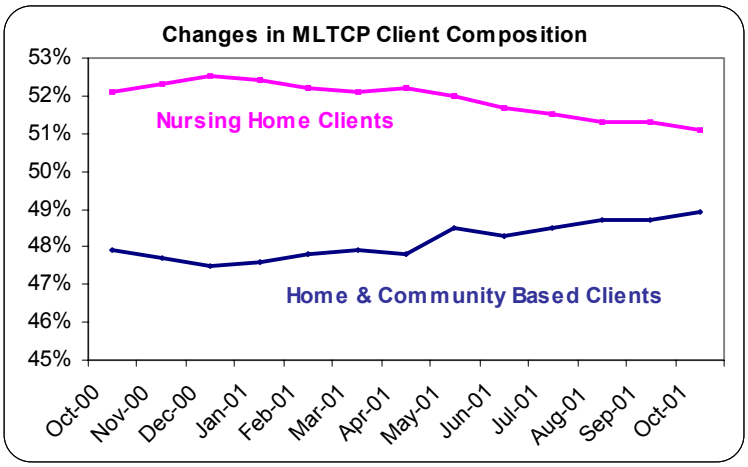
Potential Reasons for Profitability Decline

1. Competition

Competition appears to have negatively impacted MLTCP's financial condition. Since October 2000, two MLTCP competitors have increased their market share of both existing and new clients. This is evident in MLTCP's declining membership level (from 9,900 members in September 2000 to 8,125 members in January 2002) and declining market share (100% in September 2000 to 73% in January 2002). These steady and consistent market share and membership reductions naturally lead to reduced net income.

2. Increasing HCBS (Home and Community Based Services) **Medical Costs**

MLTCP's per member per month medical costs are increasing. The auditors found an increase in HCBS costs, even as revenues were falling. Based on the auditors' analysis of per member per month MLTCP costs relative to the client setting mix (institutional versus home based), HCBS costs must remain low in order for the plan to be profitable. The chart on the next page shows the HCBS client base growth compared with the institutionalized (nursing homes) client base decline. MLTCP may be able to mitigate declining operating income by changing its HCBS clients' proportion, or by lowering HCBS costs.



3. Increasing General and Administrative Expenses

MLTCP General and Administrative expenses increased by approximately twice the rate as FY 2000 revenues. When revenues decreased in FY 2001, General and Administrative expenses continued to increase. MIHS' accounting structure pools certain administrative costs for all health plans into a single account and then allocates costs to each plan based upon the plan's revenue levels. NOTE: *MIHS appears to allocate proportionately more General and Administrative expense to MLTCP than to its other plans*.

As the health plan with the highest revenue level, MLTCP absorbs more administrative costs than the other health plans in the integrated system.

Potential Profitability Increase Factors

1. Increasing Capitation Rates

October 2001 capitation (revenue) rate increases (over $100 per member per month) visibly helped MLTCP. Combined with slowing plan membership attrition, capitation rate increases can contribute to net operating income level increases.

2. Change in Allowance for Claims Incurred but not Reported (IBNR)

Prior to October 2001, MLTCP's accounting policy (recommended by outside actuaries) required an additional 9% contingency to the "Incurred but not Reported" (medical bills generated but not received) reserve calculations. In October 2001 MLTCP discontinued this policy as a result of the Auditor General's FY 2001 audit. The resulting accounting change decreased October 2001 medical expenses by about $1.5 million, the amount of the reserve accumulated over three years. This accounting change will lower post-October 2001 medical expense levels.

Recommendation

MLTCP management should identify and implement strategic plans that will effectively manage any damaging trends.

Note: No representation is given regarding the achievability of the net income estimates discussed in Issue One. Achievability of estimated net income is dependent upon management decisions and the economic environment. This report provides management with information about the condition of risks and internal controls at one point in time. Future changes in environmental factors and actions by personnel will impact these risks and internal controls in ways that this report cannot anticipate.

Issue 2 Claim Payments

Summary

MIHS does not appear to have developed systems or processes that identify or avoid certain claim payment errors. The auditors found claim payment errors such as duplicate payments and overpayments. MIHS should investigate the potential duplicate payments the auditors identified, and strengthen claim payment process controls to detect errors and avoid duplicate payments.

Duplicate Claim Payments

While examining MLTCP claim payments, the auditors conducted procedures to detect duplicate vendor payments. The auditors obtained data on HCBS and Acute care claims for the period 10/31/00-12/31/01 and found 14,859 potential duplicate claim payments totaling $720,568. The auditors randomly selected 20 sets of these potential duplicates and identified six claims totaling $2,245 that were paid in error, which represents approximately 11% of the dollar value and 30% of the items in the sample. Alternately applying the dollar and incident error rates to the total potential duplicate population of $720,568 results in a potential loss ranging from $78K to $216K for the year. Because the auditors' judgmental sample is not statistically reliable, the actual loss may be more or less than the auditors' estimated loss range. Beyond this test sample, the auditors identified payment patterns indicating an unusually high number of similar odd payment amounts.

MIHS staff reviewed the potential duplicate claim payments ($720,568) and state that $40,755 was paid in error.

Adult Foster Care Provider Payments

MIHS places clients in approximately 197 Adult Foster homes at a cost of approximately $3 million per year. The auditors reviewed 353 payments made over 14 months, to 10 homes for 32 clients. The auditors found that 8% of the payments were inaccurate and that MIHS had overpaid $3,475.

Attendant Care Provider Payments

MIHS contracts with companies that provide attendant care workers who assist stay-at-home clients with daily activities. MIHS pays approximately $22 million per year for these services. The auditors reviewed 16 of MIHS' payments to these providers and found payment inaccuracies in almost half. MIHS overpaid $500 in the $7,000 payment test sample. A similarly large payment error rate in the total population ($22 million annually) would indicate significant dollar losses.

Applicable Requirements

Claims should be paid accurately, promptly, and only once. While striving to pay timely, companies normally try to avoid overpaying vendors by screening payments for common problems, such as duplicate payments and potential fraudulent activity.

Based on the auditors' testing, MIHS does not appear to have systems or processes that identify duplicate payments or other certain errors. MIHS' current claims payment system (INC) is outdated and the company who maintains the system has been unresponsive in providing assistance. MIHS has purchased a new system (OAO) which is expected to prevent duplicate payments and other errors, but the system has yet to be implemented.

Recommendation

The new claims system should reduce manual processing of claims payments and, thereby, reduce payment errors. However, management should also:

A. Investigate the identified payment errors and recover overpaid amounts if feasible.

B. Strengthen claim payment process controls to detect errors and avoid duplicate payments.

C. Proactively monitor claim payment errors and train processors to identify and correct errors.

Issue 3 Excessive Access

Summary

Programmers have access to production data and object files on the Managed Care system (VAX). Once the change has been approved through the change control procedures, they move the changes to production, which increases the risk of unauthorized modifications to the production environment. We understand that with the implementation of the new system later this year, this risk will no longer exist since the software vendor will maintain the new system. However, MIHS should restrict programmers from the current production files and allow read-only access until the new system is implemented.

Best Practices

IT best practices suggest that programmers are not granted access to production files. Modifications and enhancements should be developed and tested in a separate environment, with the approved results being moved into production by a Production Control Group.

Risks

The risk of unauthorized modifications to the production environment is increased. MIHS no longer has a Production Control Group since most systems are vendor managed. As a result, migration responsibilities have become part of the programmer's activities. We understand that with the implementation of the new system later this year, this risk will no longer exist since the software vendor will maintain the new system.

Recommendation

MIHS should restrict programmers from the production files and allow read-only access while on the current Managed Care system (VAX).

Issue 4 Inactive Accounts

Summary

An excessive number of inactive and disabled accounts exist on the Managed Care system (VAX). The situation increases the risk that these accounts will be reactivated, thereby granting unauthorized levels of access to system resources. MIHS should review profiles for disabled and inactive user accounts and delete those that are no longer needed.

Best Practices

IT best practices indicate that inactive and disabled user accounts should be purged from the system on a timely basis.

Business Risk

More than 60 profiles have the DISUSER flag set and several other profiles have been inactive for a long period of time (greater than 12 months). The risk is increased that these accounts will be reactivated, thereby granting unauthorized levels of access to system resources. MIHS has been unable to gain approval of department managers to delete disabled and inactive accounts from the system.

Recommendation

MIHS should review and consider deleting the following profiles:

A. DISUSER flag set with no activity (interactive or batch) in the past 30 days.

B. Password has been expired for greater than 60 days.

C. Password in the pre-expired status with no activity (interactive and batch) logged.

D. No activity (interactive or batch) in the past year.

Issue 5 Unique OPERATOR ID

Summary

Five unique IDs with system level privileges, established for individuals within Operations/Help Desk, are not being used appropriately. System activity performed under the OPERATOR account cannot be identified to any one individual. During the audit, profiles of the Operations/Help Desk, staff who require system level privileges, were modified to grant the same level of access as OPRATOR. The password to OPERATOR should be changed and distributed only on a need to know basis.

Best Practices

IT best practices include the use of unique individual IDs for critical system functions in order to maintain accountability.

Business Risk

Although unique accounts have been established with system level privileges, most have not been accessed for some time. All members of the Operation/Help Desk staff have access to the OPERATOR ID and share the identification instead of using their own assigned account.

System activity performed under the OPERATOR account cannot be identified to any one individual. Some processes require the access granted only to the OPERATOR ID and not to individual IDs. Since each member of the Operations/Help Desk staff has access to the OPERATOR ID, enforcement of individual ID usage is difficult.

During the audit, profiles of the Operations/Help Desk, staff who require system level privileges, were modified to grant the same level of access as OPERATOR.

Recommendation

MIHS should change the password to OPERATOR and distribute only on a need to know basis.

Issue 6 Password Controls

Summary

Dictionary and history password controls are being bypassed on more than 65 percent of the profiles defined on the Managed Care system (VAX). This control weakness increases the risk that users of these accounts set passwords that can easily be cracked, with dictionary cracker software. Also, users continue to use expired passwords. MIHS removed the DISPWDDIC and DISPWDHIS flags from all VAX profiles during the audit. We commend management for this prompt action.

Best Practice

Strong controls are necessary when a password is the primary means of authenticating the identity of users on a system. Strong password controls include requiring passwords to be changed regularly, minimum length of six alphanumeric characters, disallowing dictionary words, and disallowing password reuse.

Business Risk

The DISPWDDIC and DISPWDHIS flags are set on over 700 profiles that bypass the VAX system's capability to disallow passwords that are found in the dictionary and disallow reuse of passwords. The risk is increased that users of these accounts are setting passwords that could easily be cracked with dictionary cracker software and that users are continuing to use the same password after it has expired.

MIHS removed the DISPWDDIC and DISPWDHIS flags from all VAX profiles during the audit. We commend management for their prompt action.

Recommendation

None, for information only.

Issue 7 Disaster Recovery Plan

Summary

MIHS has not formally tested the disaster recovery plan. Without periodic testing of the disaster recovery plan, MIHS increases two risks; changes to the system configuration may not be accounted for in back-up procedures and critical data may be missing from back-ups. MIHS should review and update the disaster recovery plan and test the plan periodically.

IT Best Practices

IT best practices suggest that disaster recovery plans should be tested at least every 18 months or when significant changes are made in the configuration of the system. Although MIHS has never formally tested the disaster recovery plan, a move of the data center approximately six years ago was accomplished using the backup tapes and recovering the systems on new hardware at a different location.

Effect

Without periodic testing of the disaster recovery plan the risk increases that changes to the system configuration may not be accounted for in back-up procedures. Also, critical data may be missing from the back-ups.

MIHS has not identified specific alternate equipment that would be used in the event of a disaster. MIHS is in the process of constructing a second data center that will have redundant hardware necessary for critical systems.

Recommendation

MIHS should consider, as part of the construction phase, reviewing and updating the disaster recovery plan to enable future testing of the plan using redundant equipment.

Department Response

MARICOPA
INTEGRATED
HEALTH SYSTEM

Count on us to care.

Maricopa Medical Center
2601 E. Roosevelt St.
Phoenix, AZ 85008
(602) 344-5011

Desert Vista Behavioral Health Center
570 W. Brown Rd.
Mesa, AZ 85201
(480) 344-2000

MIHS Health Plans
- HealthSelect
- Maricopa Health Plan
- Maricopa Long Term Care Plan
- Maricopa Senior Select Plan

2502 E. University Dr., #125
Phoenix, AZ 85034
(602) 344-8700

Maricopa Home Health Care / Attendant Care
2611 E. Pierce St.
Phoenix, AZ 85008
(602) 344-2600

Arizona Integrated Pharmacy
2611 E. Pierce St.
Phoenix, AZ 85008
(602) 344-2500

Comprehensive Healthcare Center
2525 E. Roosevelt St.
Phoenix, AZ 85008
(602) 344-1015

Family Health Centers

Avondale
(623) 344-6800

Chandler
(480) 344-6100

El Mirage
(623) 344-6500

Glendale
(623) 344-6700

Guadalupe
(480) 344-6000

Maryvale
(602) 344-6900

McDowell
(602) 344-6550

Mesa
(480) 344-6200

Scottsdale
(480) 344-6050

Seventh Avenue
(602) 344-6600

South Central
(602) 344-6400

Sunnyslope
(602) 344-6300

May 13,2002

Ross Tate
County Auditor
301 W. Jefferson
10th Floor
Phoenix, AZ 85003

Dear Ross:

I have enclosed our responses to the internal audit done recently on our Maricopa Long Term Care Plan (MLTCP). I have put these in the format requested with the attachment.

Thanks for providing the opportunity to improve our services.

Sincerely,

Pat Walz
Chief Financial Officer

cc: Jody Butera, Health Plans Controller
Linda Mushkatel, VP Health Plans
Eve Murillo, Internal Audit

Maricopa Integrated Health System
MLTCP Audit Response
05/13/02

Issue #1: Profitability

Recommendation: Historically, strong MLTCP profit margins have kept MIHS profitable as a whole, and MIHS needs strong MLTCP profit margins to remain self supporting. However, throughout FY 2001, MLTCP showed significantly decreasing profitability.

Response: Concur, with reservation.

We believe the use of Method One to determine future net income (loss) is flawed. The methodology assumes continuing decreases in profitability based on decreasing membership. The use of a 24-month time frame includes a one-time decrease in membership when the state chose to allow competition in the market. This decision by the state created a one-time decrease in covered patients by 20%. This is not likely to happen again.

We support methodology Number 2 which removes the impact of the state decision and "significantly shifts annualized operating income trends in a positive direction". (Internal Audit Report page 10)

Recommendation: MLTCP Management should identify and implement strategic plans that will effectively manage any damaging trends.

Response: Concur

We currently have a network management committee that is charged with membership growth and retention, and the reduction of the erosion of membership. They have addressed strategic issues relative to MLTCP membership.

We are analyzing the cost and revenue of both Nursing home Clients and Home and Community Based Clients (HCBC). It is inappropriate to assume a growth in HCBC clients will result in improved bottom line as this will also reduce the capitated revenue amount in future periods. This analysis should be complete by 06/30/02.

We are reviewing administrative costs across all lines of our Health Plan Business. Our administrative costs run 6.24% of the Health Care Resources compared to an industry standard of 8%. This review will also be completed by 06/30/02.

Issue #2: Claims Payments

Summary

MIHS does not appear to have developed systems or processes that identify or avoid certain claim payment errors. The auditors found claim payment errors including duplicate payments and overpayments. MIHS should investigate the potential duplicate

payments the auditors identified, and strengthen claim payment process controls to detect errors and avoid duplicate payments.

Duplicate Claim Payments

While examining MLTCP claim payments, the auditors conducted procedures to detect duplicate vendor payments. The auditors obtained data on HCBS and Acute care claims for the period 10/31/00-12/31/01 and found 14,859 potential duplicate claim payments totaling $720,568. The auditors randomly selected 20 sets of these potential duplicates and identified six claims totaling $2,245 that were paid in error, which represents approximately 11% of the dollar value and 30% of the items in the sample. Alternately applying the dollar and incident error rates to the total potential duplicate population of $720,568 results in a potential loss ranging from $78K to $216K for the year. Because the auditors' judgmental sample is not statistically reliable, the actual loss may be more or less than the auditors' estimated loss range. Beyond this test sample, the auditors identified payment patterns indicating an unusually high number of similar odd payment amounts.

MIHS staff reviewed the potential duplicate claim payments ($720,568) and state that $40,755 was paid in error.

Adult Foster Care Provider Payments

MIHS places clients in approximately 197 Adult Foster homes at a cost of approximately $3 million per year. The auditors reviewed 353 payments made over 14 months, to 10 homes for 32 clients. The auditors found that 8% of the payments were inaccurate and that MIHS had overpaid $3,475.

Attendant Care Provider Payments

MIHS contracts with companies that provide attendant care workers who assist stay-at-home clients with daily activities. MIHS pays approximately $22 million per year for these services. The auditors reviewed 16 of MIHS' payments to these providers and found payment inaccuracies in almost half. MIHS overpaid $500 in the $7,000 payment test sample. A similarly large payment error rate in the total population ($22 million annually) would indicate significant dollar losses.

Applicable Requirements

Claims should be paid accurately, promptly, and only once. While striving to pay timely, companies normally try to avoid overpaying vendors by screening payments for common problems, such as duplicate payments and potential fraudulent activity.

Based on the auditors" testing, MIHS does not appear to have systems or processes that identify duplicate payments or other certain errors. MIHS' current claims payment system (INC) is outdated and the company who maintains the system has been unresponsive in providing assistance. MIHS has purchased a new system (OAO) which is expected to prevent duplicate payments and other errors, but the system has yet to be implemented.

Recommendation

The new claims system should reduce manual processing of claims payments and, thereby, reduce payment errors. However, management should also:

A. Investigate the identified payment errors and recover overpaid amounts if feasible.

B. Strengthen the claim payment process controls to detect errors and avoid duplicate payments.

C. Proactively monitor claim payment errors and train processors to identify and correct errors.

Response: Duplicate Claims Payments

Concur with clarification.
MIHS conducted a 100% review of 14,859 potential duplicate claims which was composed of 29,000+ claim lines. True duplicate payments in this population totaled $40,755. This is an error rate of 1.6% in claim lines and 5.6% in dollars.

Response: Adult Foster Care Payments

Concur.

Response: Attendant Care Provider Payments

Concur.

General Comments

- MIHS will implement monthly post payment audits for HCBS providers to include on-site auditing of SAF, timecards and supporting documentation beginning in May 2002.

- MIHS will run monthly duplicate payment report until the new OAO system is fully implemented. MIHS is currently auditing 5% of the claims processed on a monthly basis.

- Audit findings will be utilized for training opportunities and assist in identifying areas needing improvements or potential fraudulent activity.

- New claims procedures and processes will be fully implemented by January 2003 in conjunction with the new information system.

Issue #3: Excessive Access

Recommendation: Programmers have access to production data and object files on the VAX system. Once the change has been approved through the change control procedures, they move the changes to production. The risk of unauthorized modifications to the production environment is increased. We understand that with the implementation of the new system later this year, this risk will no longer exist since the software vendor will maintain the new system. MIHS should restrict programmers from the current production files, and allow read only access while on the VAX system.

Response: Concur

Implementation not currently possible. We do not have a Production Control Department. Our two programmers developed all of the applications currently running on the VAX system in house. All system changes and bug fixes are developed/coded by our programmers. All code changes are tested before they are moved into Production. We follow audited change control procedures, which include an audit trail, and all adds/changes are approved before moves can be made into the Production environment. As you stated above, we will sunset this system once the new Health Plans Applications is live, approximately September 2002 and the vendor will maintain the new system.

Target Completion Date: September 2002.

Issue #4: Inactive Accounts:

Recommendation: An excessive number of inactive and disabled accounts exist on the VAX system. The risk is increased that these accounts will be reactivated, thereby granting unauthorized levels of access to system resources. MIHS should review profiles for disabled and inactive user accounts and delete those that are no longer needed.

Response: Concur

Corrected during the Audit. All inactive accounts were removed, and HR is sending the help desk a weekly list of all terminated employees from which we follow our termination procedures to remove the accounts.

Target Completion Date: 3/15/02 - completed.

Issue #5: Unique OPERATOR ID

Recommendation: Five unique IDs with system level privileges have been established for the individuals within Operations/Help Desk, but are not being used appropriately. Accountability of the system activity performed as the OPERATOR account cannot be

identified to any one individual. During the audit, profiles of the Operations/Help Desk, staff who require system level privileges, were modified to grant the same level of access as OPRATOR. The password to OPERATOR should be changed and distributed only on a need to know basis.

Department reports are reconciled to Advantage reports on a monthly basis. Variances are adequately investigated.

Response: Concur

Corrected during the Audit. We changed the password on the operator account to force the operators to use their individual account.

Target Completion Date: 3/15/02 - completed.

Issue #6: Password Controls

Recommendation: Dictionary and history password controls are being bypassed on over 65% of the profiles defined on the VAX system. The risk is increased that users of these accounts are setting passwords that could easily be cracked with dictionary cracker software, and that users are continuing to use the same password after it has expired. MIHS removed the DISPWDDIC and DISPWDHIS flags from all VAX profiles during the audit. We commend management for their prompt action.

Response: Concur

Corrected immediately after the audit. The flags were removed from the profiles that had them turned on.

Target Completion Date: 3/15/02 - completed.

Issue #7: Disaster Recovery Plan

Recommendation: MIHS has not formally tested the disaster recovery plan. Without periodic testing of the Disaster Recovery Plan the risk is increased that changes to the system configuration may not be accounted for in the back-up procedures and critical data may be missing from the back-ups. MIHS should review and update the disaster recovery plan and test the plan periodically.

Response: Do not concur

We have not done a 'Hot Site' test, but we have successfully moved/tested the Data Center recovery twice in 7 years. The first move was done by having identical equipment in the down town data center (CBT) and restoring everything from tape, to eliminate the down time. The second move was done by shutting down the equipment and moving it.

We have also done several system recoveries from tape, on the financial system after the database was corrupted. We have restored single file as needed on the vax system, and we do test our backup procedure quarterly. When new systems are added/installed to our configuration, we add these systems to our disaster recovery plan and our plan is review annually for accuracy.

Approved By:

N/A
Department Head/Elected Official — **Date**

Mark Holland
Chief Officer — 5/23/02 **Date**

D R Scott
County Administrative Officer — 5/24/02 **Date**